87-51

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No. _____

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1986

MAGDALINE M. HANSEN, individually and on behalf of all those similarly situated,

Appellants,

v.

THE CITY OF SAN BUENAVENTURA,

Appellee.

ON APPEAL FROM
THE SUPREME COURT OF CALIFORNIA

JURISDICTIONAL STATEMENT

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QUESTIONS PRESENTED

The Ventura Water System is a public utility owned by the city of San Buenaventura (hereinafter "Ventura"), which provides water service to customers within city limits and to customers outside the city as well. Under Ventura's municipal rate-setting ordinances, the nonresident water customers pay 70% more than is paid by in-city water customers of the city for the same water service.

The questions presented are:

1. Is it a denial of equal protection of the laws for out-of-city customer ratepayers of a city-owned water system to be separately classified solely on the basis of their nonresident status, and required to pay a seventy percent (70%) surcharge over and above in-city water rates for the same service, when: (a) There is no

difference in the cost of providing water to the in-city customers as opposed to out-of-city customers of the water system; (b) all repayments of principal and interest on bonds issued to finance the acquisition of the water system and its improvements have been made from water system revenues received from all customers (resident and nonresident), and not from taxes; (c) all operating expenses on the books of the water system are paid from the rate revenues of all customers (resident and nonresident), and not with tax funds.

2. Where the record shows that a city's assertions of the legislative purposes for a rate surcharge were not the actual, articulated purposes for which the city council imposed the 70% surcharge on out-of-city customers, and

where the record shows that the asserted purposes could not have been the goal of the surcharge legislation, should not the courts reject such asserted purposes in equal protection analysis, under the rationale of Weinberger v. Wiesenfeld (1975) 420 U.S. 636, 648, 95 S.Ct. 1225, 1233, n.6.

3. Is it an impermissible legislative purpose and therefore a denial of equal protection for a city-owned utility to earn a profit or return on investment from nonresident customers when those customers have provided the investment? And, assuming arguendo that this is permissible, is it a denial of equal protection for a city to charge a return on investment against out-of-city customers of its water system without charging an identical return against in-city customers.

4. Where city ordinances impose a surcharge on water customers who are nonresidents, where the revenue studies accepted as justifications for the surcharge exclude substantial revenues from out-of-city customers, and where the reasons given for excluding such revenues are unrelated to the reasons given for separately classifying nonresidents, is there a denial of equal protection.

5. When a city-owned utility imposes a 70% surcharge on its nonresident customers, and when the surcharge bears either no relationship of any kind, or no reasonable, real and substantial relationship, to any legitimate purpose, are such nonresident ratepayers deprived of substantive due process.

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JURISDICTIONAL STATEMENT

Magdaline M. Hansen, individually and on behalf of all those similarly situated, appeals from the final judgment of the Supreme Court of California, filed December 31, 1986, holding that municipal ordinances which impose a seventy (70) percent surcharge only on nonresident customers of the water system of the City of San Buenaventura are valid.

OPINIONS BELOW

The opinion of the California Supreme Court is reported at 42 Cal.3d 1172, 233 Cal.Rptr. 22, and is reproduced in the Appendix separately presented[1] at pages 1-73. The Opinion, and the Opinion on Denial of Rehearing and Modification of Opinion of the Court

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[1]Rule 15.1 of the Rules of the Supreme Court permits an appendix to be separately presented if the required contents are voluminous.

of Appeal of California, Second Appellate District, Division Six, are unreported, and are reproduced in the Appendix at pages 75-221 and 222-230, respectively. The Findings of Fact and Conclusions of Law and the Judgment of the Ventura County Superior Court of the State of California are unreported, and are reproduced in the Appendix at pages 231-333 and 334-336.

JURISDICTION

The decision of the California Supreme Court, holding that municipal ordinances imposing a 70% surcharge on nonresident customers of the Ventura Water System are valid, was filed on December 31, 1986. Appellants timely filed a petition for rehearing. The Court extended the time for granting or denying rehearing to February 27, 1987, and on February 5, 1987, denied appellants' petition for rehearing, at

which time the judgment became final. A copy of the Order of the California Supreme Court denying appellants' petition for rehearing is reproduced in the Appendix at page 74. Notice of Appeal to this Court was timely filed with the California Supreme Court on March 23, 1987. A copy of the Notice of Appeal is reproduced in the Appendix at pages 337-338. On April 23, 1987, within 90 days from the denial of rehearing below, appellants filed an application for a 60-day extension of time within which to docket their appeal in this Court, said extension to and including July 5, 1987. On April 24, 1987, the application was granted. This appeal is being docketed in this Court within the extension granted. The jurisdiction of this Court is invoked

under 28 U.S.C. section 1257(2).[2]

CONSTITUTIONAL PROVISIONS AND ORDINANCES INVOLVED

Fourteenth Amendment, United States Constitution: "No State shall. . . deny to any person within its jurisdiction the equal protection of the laws."

Ordinances of the City Council of the City of San Buenaventura:[3]

Ordinance No. 1727;

Ordinance No. 75-29;

Ordinance No. 77-27.

I. STATEMENT OF THE CASE

A. Appellants Raised Their Constitutional Claims at Every Level Below.

The instant case is a class action that was brought on behalf of over 3,000 plaintiffs who are out-of-city customers

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[2]City ordinances are state statutes within the meaning of 28 U.S.C. Section 1257(2). King Manufacturing Company v. City Council of Augusta et al (1928) 277 U.S. 100, 102-114.

[3]The pertinent text of these ordinances is set forth in the Appendix at pages 339-344.

of the Ventura Water System. At every step of the way in the lower courts, appellants pressed their constitutional claims.

The complaint was filed on June 8, 1973, seeking declaratory relief concerning the validity of the water rates charged to plaintiffs, and damages for the amounts paid pursuant to the surcharge. (CT 1)[4] The allegations of the complaint included the following: "Defendant's ordinance, as it applies to plaintiffs, is therefore violative of the due process and equal protection clauses of the Constitution of the United States ..." (CT 2) In their opening brief at trial, appellants argued that since they were in essentially the same position as the in-

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[4]It was agreed that plaintiffs would make no claim of invalidity or damages based on water rates in effect prior to July 1, 1972. (RT 3)

city customers with regard to cost of service and financing of the system, that the equal protection clauses of the California and United States Constitutions require that they be treated alike. (CT 264, 250-265.) Appellants also asserted in this brief that the 70% surcharge deprives them of substantive due process. (CT 265-267). The trial court rejected plaintiffs' constitutional claims.
(CT 472.)

Appellants raised the same constitutional (and common law) issues in their appellate briefs. The appellate court expressly refused to rule on the constitutional claims: "We conclude that the answer...is found in venerable common law rules and, accordingly, decline to consider the consitutional arguments advanced by the parties." (Appendix p. 77.) In a unanimous

decision, the appellate court reversed the trial court, holding that "a miscarriage of justice occurred requiring us to reverse judgment...", concluding "that in the case before us, reason was replaced by several fictions." (Slip Opinion, page 71 & 72, Appendix p.175)[5]

Appellants pressed these constitutional claims again, this time in their briefs before the California Supreme Court, where 19 cities filed a brief amici curiae against appellants and in support of the position of Ventura. The majority opinion

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[5]Appellants won on every major issue raised in the appellate court. But, instead of declaring the surcharge invalid, the appellate court inexplicably remanded the case for an entire new trial along with its reversal. The City appealed to the California Supreme Court, as did appellants, appellants hoping to avoid a retrial that in practical terms would have spelled defeat in terms of time and expense.

expressly rejected appellants' constitutional claims. It held that the "rational-basis test" applied and could be satisfied "if any state of facts reasonably may be conceived to justify it", and that Ventura met this standard (Appendix p.49), holding that a municipally-owned utility is entitled to a rate of return on its investment from out-of-city customers (Appendix p.2-3). A Concurring and Dissenting Opinion disagreed, concluding that:

"Discrimination in rates can be justified on the basis of differentials in cost in delivering water or on the basis of city contributions but not on the basis of fictitious capital contributions." (Concurring and Dissenting Opinion, Appendix p.73.)

And so appellants press their constitutional claims once more.

B. Statement of Facts.

The facts of the case are undisputed.[6]

(1) Historical Background of the Ventura Water System.

Prior to 1923, the City of Ventura and surrounding out-of-city area was served by the Southern California Edison Company. In 1923, the City purchased the water system of Southern California Edison Company, including its water rights, and commenced to provide water to in-city and out-of-city customers. (EX 51-53) The purchase was financed by general obligation bonds which were issued for the purchase of the water

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[6]When facts are not in dispute, conclusions to be drawn from such facts are questions of law for a reviewing court. Oakland Unified School District v. Olicker (1972) 25 Cal.App.3d 198, 1106-07, 102 Cal.Rptr. 421, 427; Matossian v. Fahmie (1980) 101 Cal.App.3d 128, 135, 161 Cal.Rptr. 532, 535. A reviewing court is not bound by findings or conclusions of the trial court based on undisputed facts. Hartford Accident and Indemnity Company v. All American Nut Company (1963) 220 Cal.App.2d 545, 34 Cal.Rptr. 23, 33.

system and for additions and improvements. All principal and interest were entirely paid from Ventura Water System revenues received from both in-city and out-of-city customers. No sum was ever repaid with funds derived from city real property taxpayers. (E.g., EXs 30 & 31) In 1966, the City purchased the Mound Water Company, including all of its water rights. The purchase of Mound Water Company was also made from Ventura Water System revenues, and not from City real property tax revenues. (EX 16)

In 1969, the City purchased the Saticoy Water Company, including all of its water rights, for approximately $2,000,000. As a result, the Ventura Water System became the only major purveyor of water within the city's service area. The purchase of Saticoy was financed through the issuance of

$2,500,000 of revenue bonds pursuant to the California Revenue Bond Law of 1941. All principal and interest on those bonds have been repaid entirely from Ventura Water System revenues received from both in-city and out-of-city customers; no sum whatsoever has been repaid from City real property tax revenues.[7]

While the majority of the approximately 3,000 plaintiff-appellants became customers of the Ventura Water System as a result of the Mound and Saticoy purchases, approximately 2,500 (or 60 percent) of Saticoy Water Company's customers were within City limits. They also became customers of the Ventura Water System as a result of this purchase. (EX 12)

Out-of-city customers of the Ventura

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[7]The purchase of the Saticoy Water Company by the City was in lieu of condemnation proceedings. (EX 55.)

Water System have been required to pay a surcharge over and above what in-city customers have paid for the same service since March 1, 1935.[8]

The events leading up to the increase in the surcharge imposed on out-of-city customers from 32 percent to 70 percent in 1972 were as follows:

In the spring of 1970, the consulting firm of Wilsey and Ham was retained by the City to analyze the water rate differential between customers inside the City limits and those outside the City limits who were served by the Ventura Water System, to

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[8]Commencing in 1935, through 1952, the average surcharge was 48%; from 1952 until 1972, the average surcharge was approximately 31 to 32 percent; commencing July 1, 1972, and through the present time, the surcharge imposed upon out-of-city customers has been 70 percent over and above what in-city customers pay for the same service. From July 1, 1972, up to the date of trial, the 70 percent surcharge has generated revenues of approximately 1.8 million dollars. (EXs 36 & 37; EXs 6 & 7)

determine what an appropriate and proper differential should be. After analyzing data supplied by City personnel, Harold Heidrick of Wilsey and Ham sent a letter to Mr. Paul Owen, then Director of Public Works[9] of the City, which contained the following:

> "Enclosed are the preliminary results of the inside-outside rate differential study. As you can see, the results are far from the way we all had anticipated. They do justify the existing surcharge on the outside customers, but any additional surcharge would be hard to justify on the basis of available data...
> It is our opinion that the preliminary results indicate it would be difficult to justify a much larger surcharge and that no more time and effort be spent towards that end. (RT 621-621B)

The preliminary study attached to the above-described letter showed that even after charging out-of-city customers for so-called estimated subsidies to out-

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[9]The Ventura Water System is one of four divisions of the Department of Public Works.

of-city residents consisting of use of parks, swimming pool, Fiesta de la Marina, Poinsettia Festival, indirect administrative costs, and foregone interest, a surcharge of only 6.8 percent in addition to the then existing 32 percent figure would be justified.

Approximately six weeks later, on December 31, 1970, Mr. Heidrick again wrote to Paul Owen concerning the same subject:

> "So that there will be no confusion, we have stopped work on the study and recommend that no additional work be undertaken on the inside-outside rate differential study at this time. You will observe that the additional charge required to compensate your City for costs incurred for service outside the City limits is only 6.8 percent. Under the circumstances, we do not feel justified in expending additional funds in an effort to justify a higher differential."

But less than a week later, as reported in a memorandum to his file on January 11, 1971, Mr. Owen gave Mr. Heidrick "a key to the water rate study

during a phone call a week or so previously when he indicated that the oil company operating expenses and revenues would be considered separately by his department." Having given the "key" by Mr. Owen, a few days later, on January 15, 1971, Mr. Heidrick produced the Wilsey and Ham report which concluded that a surcharge of at least 70 percent would be justified.

On April 17, 1972, the Water Problems Committee of the City Council presented a report to the entire Council on its water rate study. It was recommended that the City Council consider adjusting the "outside water rates to a level of a 70 percent differential between inside and outside rates, as justified in the recent Wilsey and Ham study." (Emphasis added.) A public hearing was set for May 8, 1972. At the City Council meeting of May 8,

1972, the Chairman of the Water Problems Committee recommended the increase to a 70 percent surcharge "as justified in a recent Wilsey and Ham water rates study." (Emphasis added.) At the hearing, the City's General Services Director explained that "the 70% differential figure had been arrived at by Wilsey and Ham as that amount which was needed to provide water for county residents, based on water improvements expenditures on outside facilities." (EX 40, emphasis added.)

When the Council was questioned by County Supervisor Franklin B. Jewett as to whether it was its intention to "make money on a vital public service, ... and to generate revenues", City Manager McCombs replied stating "that it was not a question of generating revenues, rather than increasing the tax rate, but is a method of directly eliminating

subsidy of outside water users, ..." He added that the increase "would not make money ..." (EX 40) The ordinance was passed increasing the surcharge to 70 percent effective July 1, 1972.[10]

During the fiscal year 1974-75, the City hired the firm of Brown and Caldwell to perform a new water rates study. The study was performed under the direction of William K. Ferry of that firm. The large Ventura Water System revenues from out-of-city oil companies were <u>included</u> in the study and in Mr. Ferry's computation of Water System revenue requirements. (RT 939-940) One of the subjects to be considered was the surcharge to be imposed upon out-of-city customers. According to a memorandum of March 31, 1975 of a meeting between City personnel

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[10]Because of the length of footnote 9, it appears at the end of this Jurisdictional Statement.

and Mr. Ferry's staff, it would be difficult to justify outside rates 20 percent to 30 percent higher than inside based on cost of service. In spite of this, it was concluded that the 70 percent figure would be used "to support the present lawsuit." (EX 69.) The 1974-75 Brown and Caldwell study, in its final form, simply adopted the existing 70 percent surcharge on out-of-city customers. On August 11, and 18, 1975, the recommendations of Brown and Caldwell were adopted and higher water rates were put into effect by the City Council. The existing 70 percent surcharge on out-of-city customers was continued without any discussion.

In 1977, the City Council again changed its water structure and again imposed a 70 percent surcharge on out-of-city customers. The record is again totally silent concerning the Council's

legislative purpose in continuing the surcharge.

(2) There is No Difference in the Cost of Providing Water to In-City as Opposed to Out-of-City Customers of the Ventura Water System.

With one minor exception, the vast majority of plaintiff-appellants are located in "county islands" which are completely surrounded by City territory, or are in areas contiguous to the City and indistinguishable from the City. Appellants receive their water from the same sources, with the same treatment, through the same pipes, lines, and mains as in-city customers. There is no cost difference whatsoever between supplying water to out-of-city customers as opposed to supplying water to in-city customers. (RT 86-90; EXs 1 & 34.) When an out-of-city area annexes to the City, the 70 percent surcharge is removed and the residents of the newly annexed area pay the lower water rates

applicable to all in-city customers. Nothing else changes. The City admits that its water rate structure is not based upon differences in costs between serving one group of users as opposed to another, rate setting based on such a method being prohibitively expensive. (EX 8)

(3) The Ventura Water System is Operated as an Enterprise Fund.

Funds derived from City real property taxpayers are not, and never have been, used to pay Ventura Water System expenditures. (E.g., RT 432-437) This fact is supported by every document ever published by the City concerning the water system, including annual financial reports, annual budgets, and official bond statements. Without exception, these documents indicate that the Ventura Water System is, and has been, a self-supporting "enterprise

fund." (RT 210-211; EX 16)[11]

State Water Project contract obligations have also been paid solely water system revenues, never with city real property taxes. (RT 1130-31)

Damages caused by disasters or other calamities have been paid for from water system revenues, bond issues repaid from water system revenues, or State Emergency Flood Relief funds, not city real property taxes. (EX 15.) (But in 1946, $118,000 from the water fund was transferred to the sanitation fund to revamp sewage disposal facilities, and was never repaid!)[12]

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[11]Although there has been an occasional loan made from City general funds, such loans have either been completely repaid or are in the process of being repaid with interest. (RT 470-479) But in 1946, the Water System transferred $118,000 to the sanitation fund which was never repaid. (RT 1010 & EX 63.)

[12]Because it is operated as a separate, self-supporting enterprise fund, funds are transferred every year

(4) Capital Improvements of the Water System are Financed on a Self-Supporting Basis.

All capital improvements for the Ventura Water System have been financed on a self-supporting basis, and without funds from the City real property taxpayers. (EX 15)

One source of funds for capital improvements has been the issuance of general obligation bonds. Commencing in 1969, with the bonds issued for the purchase of the Saticoy Water Company, the City has only issued revenue bonds for the Water System. Revenue bond principal and interest are payable only from revenues of the Water System; there is no recourse to the taxing power of

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from the Ventura Water System to the general funds of the City to reimburse the City for services performed by non-Water Department personnel consisting of accounting and billing services. From 1974 on, $150,000 was transferred annually for these services, and lesser amounts were transferred in previous years. (EX 43)

the City for such payments. With regard to all such general obligation bonds and all such revenue bonds, principal and interest repayments have been made entirely from Ventura Water System revenues received from both in-city and out-of-city customers; not one penny has ever been paid by Ventura City real property taxpayers. (RT 212-213; EX 15.)

Non-bond water system improvements are also financed from water system related sources. The principal sources of revenue are acreage fees from developers, depreciation accruals from the water operating budget, and prior year revenue, none of which are contributions or subsidies from City general funds.

(5) Nonresident Customers and Resident Customers Were Brought into the Ventura Water System Under the Same Circumstances: By Ventura's Purchase of Private Water Companies.

Ventura became a water purveyor for residents and nonresidents when it first

assumed the role of water purveyor by purchasing the Southern California Edison Company in 1923 (EX 52.)[13] And in 1969, when the city made its last such purchase (of the Saticoy Water Company), a block of customers was thereby brought into the system of which 60% were residents of the city and 40% nonresidents. In short, nonresidents and residents were swept into the system by Ventura's initiative and acts.

II. THE QUESTIONS ARE SUBSTANTIAL

ARGUMENT

1. SURCHARGED NONRESIDENT CUSTOMERS ARE DENIED EQUAL PROTECTION, INASMUCH AS THEY ARE SIMILARLY SITUATED TO RESIDENT CUSTOMERS, AND THERE IS NO RATIONAL BASIS FOR SEPARATELY CLASSIFYING AND SURCHARGING THEM 70%.

In effect, the 70 percent surcharge creates a classification of: (1) customers who pay normal water rates,

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[13]In 1942, there were 974 out-of-city Ventura Water System service connections (EX R, App. B, Table 1), almost a third of the nonresident class of customer-appellants.

and (2) customers who pay a 70% surcharge in addition to the normal rates for the same service solely as a result of their location outside city limits. A new customer of the Ventura Water System who moves into the city is immediately given the benefit of the lower in-city rate; while a nonresident customer of many years standing, who had for years contributed to the financing of the Water System through revenues paid to the system, would pay 70% more for the same service. In the absence of any difference in the cost of providing service or in financing the Water System, as to these classes, a denial of equal protection has occurred by singling out the nonresident customers and imposing a surcharge on them which generates additional revenues of approximately $300,000 a year.

Under the two-tiered test of equal

protection analysis, a determination must first be made as to which standard of equal protection analysis is to be applied.

(a) Strict Scrutiny (Suspect Class).

The "strict scrutiny" standard is applied where a legislative classification involves a "suspect class" or penalizes the exercise of a fundamental right. Under "strict scrutiny", the governmental entity bears the burden of proving: (1) that there is a compelling state interest which justifies the law in question, and (2) that the challenged classification is necessary to promote that compelling state interest. (E.g., San Antonio School District v. Rodriguez (1973) 411 U.S. 1; Shapiro v. Thompson (1969) 394 U.S. 618; Purdy & Fitzpatrick(1969) 71 Cal.2d 566, 79 Cal.Rptr. 77; In re King (1970) 3 Cal.3d 226, 232, 90 Cal.Rptr.

15, 19.)

The strict scrutiny test should be applied in this case because the class of out-of-city water customers upon whom the 70 percent surcharge is imposed fits the criteria of a "suspect class".

The rationale behind the application of the "suspect class" doctrine is the political powerlessness of such groups.[14] San Antonio Independent School District v. Rodriguez, supra, at p.18; Purdy & Fitzpatrick v. California (1969) 71 Cal.2d 566, 580, 79 Cal.Rptr. 77, 86; Hobson v. Hansen (D.D.C. 1967) 269 F.Supp. 401, 507; see generally, Developments in the Law, Equal Protection (1969) 82 Harvard L.R. 1065, 1125; Municipal Service and Equal

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[14]Classifications based upon racial or ethnic distinctions of any sort are always considered to be "suspect" calling for the application of the strict scrutiny test (University of California v. Bakke (1978) 438 U.S. 265, 290=291, 98 Sup.Ct. 2733, 2748),

Protection (1969) 20 Hastings L.J. 1367, 1378-82. Strict scrutiny has been required for classifications which adversely affect politically powerless groups, as opposed to the normal deference the courts give to legislative and administrative judgments, for the following reasons:

> Judicial deference to these judgments is predicated in the confidence courts have that they are just resolutions of conflicting interests. This confidence is often misplaced when the vital interests of the poor and of racial minorities are involved. For these groups are not always assured of a full and fair hearing through the ordinary political processes, not so much because of the chance of outright bias, but because of the abiding danger that the power structure--a term which need carry no disparaging or abusive overtones--may incline to pay little heed to even the deserving interests of a politically voiceless and invisible minority. These considerations impel a closer judicial surveillance and review of administrative judgments adversely affecting racial minorities, and the poor, than would otherwise be necessary. Hobson v. Hansen (D.D.C. 1967) 269 F.Supp. 401, 507-8. (Emphasis added.)

The strict scrutiny test is applied to classifications which discriminate against aliens, for example, because they are denied the right to vote and thereby "lack the most basic means of defending themselves in the political processes." Purdy & Fitzpatrick v. California, supra; see also Nyquist v. Mauclett (1977) 432 U.S. 1, 97 S.Ct. 2120.

The Ventura Water System is not subject to regulation by the California Public Utilities Commission; it is totally self-regulating with regard to its water rate structure. Water rates are, and always have been, set by the City Council of defendant City. Water customers located inside City limits have the right to vote, and therefore have some measure of political control over the City Council in its role as rate setting body for the Ventura Water

System. But out-of-city customers have no right to vote for or against Council members, nor to run for office on the City Council, nor to vote for or against bonds issued to finance Ventura Water System capital improvements, and have no PUC protection as to rates imposed on them for this vital service. Since appellants are totally politically powerless with regard to the City regarding this vital service, the rationale of the "suspect class" doctrine militates toward application of that doctrine in this case. Therefore, the strict scrutiny test should be applied which shifts the burden of proof to the City to show that there is a "compelling state interest" which justifies the classification, and that it is not merely rationally based but is "necessary to promote that compelling state interest."

(b) Traditional Equal Protection Test.

But even if this standard is rejected here, the classification between in-city customer ratepayers and out-of-city customer ratepayers created by the 70% surcharge fails the traditional "rational relationship test" of equal protection analysis. That test requires that a legislative classification be rationally related to a legitimate state purpose (In re King (1970) 3 Cal.3d 226, 90 Cal.Rptr. 15, 19). All persons similarly situated with regard to the legitimate purpose of the legislation must be treated alike. Reed v. Reed (1971) 404 U.S. 71, 75-76; Royster Guano Company v. Virginia (1920) 253 U.S. 412, 415. States do not have

> "In applying [the Equal Protection Clause,] this court has consistently recognized that the Fourteenth Amendment does not deny to States the power to treat different classes of persons in different ways. [Citations.] The Equal Protection Clause of that Amendment does,

> however, deny to States the power to legislate that different treatment be accorded to persons placed by a statute into different classes on the basis of criteria wholly unrelated to the objective of that statute. A classification must be reasonable, not arbitrary, and must rest upon some ground of difference having a fair and substantial relation to the object of the legislation, so that all persons similarly circumstanced shall be treated alike." Reed v. Reed, supra, quoting with approval Royster Guano Company v. Virginia (1920) 253 U.S. 412, 415.

There is no rational relationship between the resident-nonresident classification and any legitimate legislative purpose. The out-of-city customers and the in-city customers of the Ventura Water System are in essentially similar circumstances with regard to the Water System and should be similarly treated.

(1) The Class of Resident Customers and the Class of Nonresident Customers are Similarly Situated as to Cost of Service, Financing of the System, Burdens on the System, Non-rate revenue Sources, and as Beneficiaries of the Public Trust Assumed by Ventura.

There is no difference in the cost of furnishing water to in-city as opposed to out-of-city ratepayers of the Ventura Water System; there is no difference in the financing of the system between in-city and out-of-city ratepayers; every burden placed on the Water System, such as the need to purchase additional water from more expensive water sources, is a burden placed on it by new in-city customers as well as new out-of-city customers, and benefits such in-city customers as well as out-of-city customers;[15] all non-

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[15]One of the city's experts, Thomas Stetson, attempted to justify the surcharge by arbitrarily allocating the cost of the more expensive water only to the nonresident customers of the system, and arbitrarily allocating the cost of the less expensive water from wells and the Ventura River to the resident customers. The premise behind this was that if the Ventura Water System did not have to replace supplies from the Mound and Saticoy wells, it would have no need to purchase the more expensive water from Casitas. But this ignores the fact that whatever new or additional water

rate revenue sources are from classes that lack identity with the class of resident ratepayers, and benefit either the contributors' property or all ratepayers, and therefore represent no differences between in-city ratepayers and out-of-city ratepayers, the two classes at issue. For example:

The Ventura city council requires that new development pay its way for new facilities necessitated by that development so that it does not become a drain on the existing water system. Developers therefore pay acreage and connection fees as a contribution to those capital assets which benefit the

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supplies were required for nonresidents who were former Mound and Saticoy customers were obviously required as well for residents who were former Mound and Saticoy customers. Indeed, 60% of the Saticoy Customers who were pulled into the system by the city's purchase of Saticoy were residents! The Court of Appeal clearly saw this fallacy and termed the theory "patently ridiculous" for this reason. (Appendix p.147-148.)

particular property being developed. (RT 432; RT 934-935;EXs 66, 67) This provides no basis upon which to surcharge nonresident water service rates.[16]

Power tax revenues are revenues received from the United Water Conservation District (UWCD), a separate governmental entity which overlaps only the eastern portion of the Water System's service area (and which includes residents of Ventura as well as nonresidents, all of whom pay taxes to the UWCD). Thus, the city boundary of Ventura separating all residents from

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[16]The ordinances imposing these fees do not distinguish between in-city and out-of-city developers. But all of this new development has been within the city since the early 1970, (the years pertinent to this litigation,) since it has been the city policy since then not to allow water service without annexation. There has therefore been no new out-of-city development that has failed to pay its way in regard to the Ventura Water System. (RT 906.)

all nonresidents has no relevance to the UWCD boundaries and any revenues received from it.

Finally, it must be borne in mind that the instant case is not a situation where property owners outside city limits approached the city and requested water service where it did not exist before; nor did the city use its own general funds to construct new plant capacity or additional mains, lines of reservoirs for the sole purpose of accommodating such customers. Instead, the out-of-city customers of the Ventura Water System became so involuntarily, as customers of companies which were then purchased by the city for its own purposes under threat of condemnation. (EX 54, 55.) In-city and out-of-city customers of the Ventura Water System are therefore similarly situated in the context of how they came into the

system, too, i.e., as beneficiaries of the public trust assumed by Ventura in its role as a purveyor of water. When a city acquires a private water system, the acquisition is impressed with a trust, and the city will hold title as a mere trustee legally obligated to serve the prior customers of the private system who are beneficiaries of the trust. Only after this obligation is satisfied may the city devote any surplus to the use of its own inhabitants who are outside of the service are of the acquired company. City of South Pasadena v. Pasadena Land and Water Company (1908) 152 Cal. 579, 93 Pac. 290; Durant v. City of Beverly Hills, supra, at 137, 102 P.2d at 761. The City became the only major water purveyor within its service area and, at the same time, assumed the obligation to furnish water to residents and

nonresidents through the acquisition of three private companies: the Southern California Edison Co. in 1923, Mound Water Company in 1966, and Saticoy Water Co. in 1969. Therefore, nonresidents and residents in each of the acquired service areas are similarly situated as beneficiaries of a public trust. As in all trust situations, the trustee must act with total impartiality to the beneficiaries, without favoring its own constituents.

(2) City Property Tax Liens Which are Decreasing and Have Never Been Called On Provide No Rational Basis for the Imposition of a 70% Surcharge on Nonresident Customers, Nor Do Reconstructed Indirect Administrative Expenses.

The issue of City property being subject to liens for general obligation bonds and State Water Project obligations as a claimed justification for the surcharge is a red herring. These deal with contingent liabilities

that have never been called upon, since all principal and interest payments on general obligation bonds and all contract payments on the State Water Project have always been paid out of water revenues of all ratepayers, both in- and out-of-city (RT 212-231; EX 16, 30, RT 1130-31). Thus, to accept this as a basis for the surcharge is in effect assessing non-resident ratepayers for these contingent liabilities before the property taxpayers are so assessed.[17]

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[17]This is particularly irrational and inequitable in light of the fact that property owners voted for the bonds and therefore bound themselves to such a potential liability if the need should arise in the future; the out-of-city ratepayers never voted on such bond issues yet are now liable for this contingent liability before the contingency arises!) Moreover, as general obligation bond contingent liability has decreased over the years, the surcharge has increased. (EX 6) These contingent liabilities are fictions insofar as the history and present situation of the Ventura Water System is concerned, as recognized by

Shortly before trial, to support its position, the City reconstructed the value of time of non-water department city personnel and office space it has incidentally provided over the years without charge to its Water System. Current city personnel estimated the level and extent of services provided for the Water System as far back as 6 and 7 years ago. This reconstruction showed that resident customers of the city-owned Water System indirectly pay very little of this "expense" (which has never appeared on the books of the Water System), while surcharged nonresident customers of the Water System in effect pay more than 10 times their share of such reconstructed salaries and rent. Clearly the proper way to compensate the city for such services and rent is by having the water system reimburse the

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the Dissenting (Appendix p.67-68).

city from the revenues of all customers, just as the Water System reimburses the city for billing and accounting services to the tune of $150,000 each year. It surely provides no basis for distinguishing between resident and nonresident customers by means of a nonresident surcharge that brings in approximately $300,000 per year, when the portion of these indirect administrative expenses attributable to nonresidents amounts to only $26,000 per year. (RT 175, EX R)[18] The dissent clearly recognized this. (Appendix p.68-

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[18]These reconstructed expenses of course never appear on the books of the Ventura Water System, and the general fund never gets reimbursed! Moreover, there is a lack of identity between in-city water ratepayers and the sources of general funds which pay the salaries of non-water department personnel and rental space. General funds come mainly from sales, utility and franchise taxes, licenses and permits, intergovernmental federal, state and county sources, fines and forfeitures, and city charges for current services. (EX 16.)

70).

2. PROFIT OR RETURN ON INVESTMENT WAS NOT THE ACTUAL, ARTICULATED PURPOSE OF THE SURCHARGE ORDINANCES, AND SHOULD THEREFORE BE REJECTED AS A JUSTIFICATION FOR THE SURCHARGE.

The City Council minutes and other legislative materials show that the adoption by the City Council of a 70% surcharge was based entirely upon the recommendations contained in the Wilsey and Ham report of January 15, 1971 (EX 35). Therefore, since the Wilsey and Ham report was the actual basis for the City Council's action in adopting and maintaining the 70% surcharge, the constitutional propriety of that action must be evaluated based on that report, and not on theories created and applied by consultant's years later in an attempt to bolster the city's position at trial. As stated by the United States Supreme Court:

> This court need not in equal protection cases accept at face value assertions of legislative

purposes, when an examination of the legislative scheme and its history demonstrates that the asserted purpose could not have been a goal of the legislation. Weinberger v. Weisenfeld (1975) 420 U.S. 636, 648, 95 S.Ct. 1225, 1233; Women's Liberation Union v. Israel (D.R.I. 1974) 379 F.Supp. 44, 49; Brown v. Merlo (1973) 8 Cal.3d 855, 865 n. 7, 106 Cal.Rptr. 388, 395, n. 7

But the Wilsey and Ham Report was inadequate beyond dispute as a justification for the 70% surcharge. This report justified the 70% surcharge as a reimbursement for so-called "subsidies" made to out-of-city customers by the City and which totalled $172,000 for the test year utilized. (RT 129-20; EX 35.)[19]

The first category of subsidies totalled $32,000 and charged the out-of-city water customers for the use by all out-of-city residents of city parks,

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[19]The Wilsey and Ham analysis did not address the issue of the 32% surcharge which already existed; it merely accepted its permissibility and used its revenues in its computations.

swimming pool, Fiesta de La Marina, Poinsettia Festival, etc. At the trial, Mr. Heidrick, the author of the Wilsey and Ham Report, admitted that such factors are not properly considered.

The major "subsidy" included in the Report was the sum of $135,000 representing "foregone interest on investment in plant servicing the county." Mr. Heidrick's theory was that if the city did not have its investment in that portion of the Ventura Water System attributable to servicing out-of-city customers, it could have used those funds elsewhere, or at least interest could have been earned on those funds. (RT 543-545.) But "foregone interest" is a fiction under the undisputed facts of this case. The city did not take a portion of its general funds, which might have been used elsewhere, in order to construct or purchase additional

improvements to the Water System for the purpose of assisting out-of-city customers. Quite the contrary, capital plant and equipment of the Ventura Water System has come form its own revenues, or from bond issues which have been and are being repaid from its revenues. There was no existing fund, or investment, upon which the city was losing money as a result of its servicing out-of-city customers. (RT 432-434.)

The city, recognizing the infirmities of the Wilsey and Ham Report and recognizing the necessity of coming up with a justification that accounted for most of the surcharge[20], came up

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[20]Under City of Madera v. Black (1919) 181 Cal. 306, 315, 184 Pac. 397, 402, Guy S. Atkinson Co. v. Highland Park Public Utility District (1958) 158 Cal.App.2d 718, 721, 723-724, 323 P.2d 173, 175, 177, Durant v. City of Beverly Hills (1940) 39 Cal.App.2d 133, 139, 102 P.2d 759, 763, and County of Inyo v. PUC (1980) 27 Cal.3d 154, 159, 161 Cal.Rptr.

with the after-conceived justification of the right of the city to extract a profit or return on investment from out-of-city ratepayers, as embodied in the Brown and Caldwell Report's utility method of analysis for nonresidents.

But the record in this case shows that the Brown and Caldwell Report of February 1978, justifying the 70% surcharge as a profit or rate of return, was never put before the City Council. The City Council never authorized the Water System to be operated for profit or return on investment; yet the Court below accepted this as a justification for the surcharge. This Court should reject profit or return on investment as a justification for the surcharge; to do otherwise makes a sham of the public

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172, 175, where a portion of a rate charge is improper, the court may not rule on what the components of the charge should be, but must instead declare the entire charge invalid.

hearings held in April and May of 1972 which resulted in the adoption of the 70% surcharge. To ignore the uncontradicted evidence of the actual legislative purpose and to permit the surcharge to be justified by a report conceived many years later, also has the effect of transferring governmental power from the City Council to an outside consultant. The 70% surcharge should be evaluated by the Court on the basis of its true purpose and legislative objective: the recovery of fictitious subsidies.[21]

3. PROFIT EXTRACTED FROM OUT-OF-CITY CUSTOMERS IS A DENIAL OF EQUAL PROTECTION.

The California Supreme Court did not even consider the Wilsey and Ham Report. It held that a municipal utility is

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[21]The omission of oil company revenues and expenses from the Wilsey and Ham and Brown and Caldwell reports is discussed in section 4, below.

entitled to a reasonable rate of return, thereby validating the surcharge ordinances under the theory espoused in the later-conceived Brown and Caldwell report.[22] But rate of return is impermissible here.

In addition to the requirement of a rational relationship between the statutory classification and the legislative purpose to be served, equal protection requires that such purpose be legitimate or permissible. Metropolitan Life Insurance Co. v. Ward (1985) 105 S.Ct. 1676-1684. It is a basic tenet of public utility law that ratepayers of a utility may not be forced to both provide the investment for a utility and a profit or return on that investment. The majority opinion runs counter to this

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[22]It thereby expressly rejected the rationale of Weinberger, supra, by accepting any conceivable basis for the surcharge. (Appendix p.49)

basic tenet and runs counter to equal protection in validating an impermissible purpose.

Privately owned utilities are owned by investors who have a right to a reasonable rate of return on the value of the property they have devoted to public use. Southern California Gas Co. v. P.U.C. (1979) 23 Cal.3d 470, 476, 153 Cal.Rptr. 10, 13. In such systems, "requiring ratepayers to put up the capital for the [utility] is contrary to the basic principle of utility rate setting." City and County of San Francisco (1971) 6 Cal.3d 119, 129-130, 98 Cal.Rptr. 286, 291. If rates resulted in ratepayers contributing capital to the utility as well as a rate of return, it would " 'provide a source of interest-free capital' " for investors. City and County of San Francisco, supra. Thus, it is clear

that utilities may not both earn a rate of return on capital and at the same time force the ratepayers to contribute to that capital through their rates; this would permit a "double return" to the utility. Pacific Tel. & Tel. Co. v.P.U.C. (1965) 62 Cal.2d 634, 663-664. (Dissent, Appendix p.61-63)

In a city-owned system such as Ventura's, where the city issues bonds to pay for its system which are paid off by the customers, the ratepayers necessarily provide the investment. In conformity with age-old utility law, a profit or return on investment should therefore be barred. And, indeed, so it is under California Government Code sec. 54514 of the Revenue Bond Law[23], the obvious counterpart to the investor-owned utilities proscription against a

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[23]Ventura's revenue bonds have all been issued under this Law.

double recovery. Government Code section 54514 provides as follows:

> Subject to the provisions of Section 54516.1, the local agency shall prescribe, revise and collect such charges that the services, facilities or water of the enterprise are furnished at the lowest possible cost consistent with sound economy, and prudent management, and the security and payment of the principal and interest of the bonds. (Emphasis added.)

This section precludes profit or return on investment, by its express terms; such an objective for the surcharge is therefore impermissible and therefore a denial of equal protection. Metropolitan Life Insurance, supra.

Moreover, even if profit or return on investment was a legitimate, permissible legislative purpose, it is a denial of equal protection for a city to charge such a profit from its nonresident customers without charging the same profit from its resident customers, since both classes are

similarly situated in every context relevant to the Water System. County of Inyo v. P.U.C. (1980) 27 Cal.3d 154, 159 n.4, 161 Cal.Rptr. 172,175 n.4 provides that a showing that "discrimination [in rates] rests solely on the nonresident status of the customer, and not on the cost of service or some other reasonable basis, will prove the rate invalid." Extracting a profit only from nonresidents is the clearest case of a discrimination resting solely on the nonresident status of the customer; profit is by definition not based on cost of service or any other basis of differentiation. It is therefore impermissible.[24]

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[24]The California Supreme Court misstated appellant's assertion of the impermissibility of profit, characterizing it as an assertion that water service must be provided at "cost". Appellants never made this claim. Appellants merely claimed that profit or return in investment was prohibited when the ratepayers provided

4. THE ARBITRARY EXCLUSION OF OUT-OF-CITY OIL COMPANY REVENUES FROM THE CITY'S REVENUE STUDIES VIOLATES MINIMAL EQUAL PROTECTION STANDARDS.

The challenged ordinances create a classification of in-city and out-of-city rates, imposing the surcharge on commercial, industrial and household water consumption. The only water outside of this legislative classification is raw water used for irrigation, which makes no distinction as to residents and nonresidents.

The Wilsey and Ham and Brown and Caldwell revenue studies assumed that one could separately classify in-city customers from out-of-city customers, and then did a revenue requirement study based on this assumption to determine

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the investment. Appellants further asserted that whatever could be validly charged to ratepayers should be charged to all ratepayers. For example, reserves for future expansion would be an item over and above cost, but should certainly be charged to all customers to satisfy equal protection mandates.

the amount of the surcharge. But the study arbitrarily excluded the large industrial out-of-city oil company revenues and expenses. If the huge revenues and expenses of the Shell and Getty out-of-city oil companies had been included in the computations of the city's experts, by their own admission the results reached would be dramatically different (RT 621-622). The Wilsey and Ham report would have computed only a 38.6% surcharge, (most of which was the 32% surcharge which already existed). The Brown and Caldwell report would have computed only a 33.9% surcharge.

The reasons given by the city's experts for excluding these revenues and expenses are related to cost factors, such as the fact that Shell receives totally untreated water and Getty receives partially treated water. But

these contentions are constitutionally infirm, since water treatment is irrelevant to the asserted purposes of the surcharge classification; the supposed justifications for singling out-of-city ratepayers from in-city ratepayers have nothing to do with water treatment. Water treatment is a criterion wholly unrelated to the supposed objective of recovering subsidies or a rate of return from out-of-city customer, and therefore flies in the face of equal protection.

If rates are set by determining revenue requirements for certain classes of customers, then the rationale that determines the classes must be uniformly applied to all those who fit that criterion. Anything less is a denial of equal protection, which requires that "at a minimum, 'persons similarly situated with respect to the legitimate

purpose of the law receive like treatment.' " Brown v. Merlo, supra; Reed v. Reed, supra. If the rationale is based strictly on political boundary, as where it is claimed that indirect "subsidies" are given to out-of-city customers, this rationale applies to all out-of-city customers. The uniform application of this rationale mandated by equal protection requires that revenue requirements for out-of-city customers be determined by utilizing revenues and expenses of all out-of-city customers.

The same is true with regard to the return on investment justification relied on in the Brown and Caldwell report. Even if return on rate base only from out-of-city customers was valid, then it should logically apply to all out-of-city customers, including oil companies.

To simply omit one of the most lucrative portions of sales to out-of-city customers constitutes a flagrant violation of constitutional principles of equal protection which require that legislatively-created classifications, even if created pursuant to acceptable legal criteria, must be complete and must fully include all those persons who logically come within the relevant criteria. Exclusions from the class may not be based on irrelevant criteria.

The city's attempt to ignore these revenues is particularly incredible in light of the fact that the 70% surcharge has been paid by the oil companies for much of the time frame covered by this lawsuit. (RT 265-6, 390-392, EXs 44,45.) If water treatment justifies excluding oil company revenues and expenses from the out-of-city computations used to arrive at the amount of the surcharge,

does it not also justify excluding oil companies from being surcharged?

Amazingly, while Mr. Ferry, the author of the Brown and Caldwell report, testified that he deleted oil company revenues and expenses, he made no deletion whatsoever from the Ventura Water System rate base, and made no deletion whatsoever from normal water system expenses such as administrative expenses, customers accounts, transmission and distribution expenses, property taxes, or depreciation expense. (RT 840-842.) In effect, therefore, all of these other expenses were divided between the in-city and out-of-city potable water users; the oil companies were given a free ride in the computations.

The final irony and inequity can be perceived in the city's attempt to use what it calls unreimbursed services

allegedly performed for the Water System over the years by nonwater department personnel as a rationale for the surcharge. If this were a legitimate rationale, then why does the city use only the revenues of potable out-of-city customers to compute the surcharge? Magically, the oil companies have not been assisted by all of these services. This is another indication of the total irrationality of a classification between in-city and out-of-city customers which attempts to exclude from consideration two out-of-city customers who alone contribute roughly 10% of the annual revenues of the entire Ventura Water System.[25]

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[25]As said by the Court of Appeal: "You do not have to be a PHD in economics from Harvard to understand what happens when you eliminate a source of profit from your books of account." (Appendix p.227) And, as pointed out above, the city's own experts included those revenues and expenses when first hired by the city!

5. THE 70%SURCHARGE DEPRIVES OUT-OF-CITY CUSTOMERS OF THE VENTURA WATER SYSTEM OF SUBSTANTIVE DUE PROCESS OF LAW.

What has come to be known as "substantive due process," pursuant to the Fourteenth Amendment of the United States Constitution, is essentially a protection against arbitrary legislative action. A legislative enactment "must not be unreasonable, arbitrary or capricious but must have a real and substantial relation to the object sought to be attained." Gray v. Whitmore (1971) 17 Cal.App.3d 1, 22, 94 Cal.Rptr. 904, 915. (Emphasis added.) The essence of substantive due process is the basic concept of fair play. Id at 28, 94 Cal.Rptr. at 919.

There is simply no relationship between the $300,000 annually derived from the 70% surcharge and any legitimate purpose.

III. THE FEDERAL QUESTIONS ARE

IMPORTANT AND SHOULD BE DECIDED BY THIS COURT.

The practice of charging nonresidents more than residents of a city-owned utility is a nationwide practice, yet this Court has never passed on its constitutionality. The practice is particularly egregious in California where nonresidents do not even have the protection of a public utilities commission as they do in many other states. In the 1960s, the California Constitution Revision Commission, in analyzing the authority of municipalities to provide utility service to nonresidents, addressed the problem of the potential for abuse as to such politically powerless utility customers, recognizing that:

> "The persons receiving such services, being non-residents, have little or no political power which may be exercised to prevent abusive treatment...[T]he city retains substantially full control over its own utility operations outside its boundaries, without any developed

> legal standards (other than the last-ditch constitutional arguments of Equal Protection and Due Process) as a basis for judicial review of ... practices detrimental to... nonresident utility consumers such as discriminatory rates or charges." California Constitution Revision Commission, Background Study relating to Article XI: Local Government, p.396,(emphasis added).

And, even the "last-ditch" argument of equal protection becomes dangerously attenuated if the legislature is not accountable for its actual, articulated purpose in enacting such class legislation. Most pertinent on this issue is the observation of Justice Brennan in his dissenting opinion in Schlesinger v. Ballard (1975)419 U.S. 498, 520-521, 95 S.Ct. 572, 583-584. Justice Brennan commented on the court's acceptance of a legislative purpose that was not in fact the actual purpose of the enactment at issue:

> Never, to my knowledge, have we endeavored to sustain a statute upon a supposition about the legislature's purpose in enacting it

> when the asserted justification can be shown conclusively not to have underlain the classification in any way.[Footnote 11: Indeed, to do so is to undermine the very premises of deference to legislative determination. . .[this] is not properly deference to a legislative decision at all; it is deference to a decision which the legislature could have made but did not.]"

The importance of this issue is enormous, and is applicable to every state and local legislative body. The California Supreme Court's acceptance of later-conceived theories never put before the city council has the effect of transferring the decision-making process to hired consultants.

The majority opinion below states that a rate of return permits past ratepayers to be credited for their past contributions to capital (Appendix p.37). But as the Dissent points out, past ratepayers versus new ratepayers "is not the basis of the discriminatory rates. (Appendix p.70) The basis is

solely political boundary. The majority opinion rests on the erroneous premise that all new customers are nonresident, and all old customers residents. In fact, residents include new customers while nonresidents include older customers.[26] But even if the majority opinion's premise had been correct, to surcharge nonresidents on this basis is a clear denial of equal protection. This court has consistently held that apportioning benefits or services on the basis of past contributions is prohibited by the Equal Protection Clause. Shapiro v. Thompson (1969) 394 U.S. 618, 632-633; Zobel v. Williams (1982) 102 S.Ct.Rptr. 2309, 2314.

The lack of uniformity in the lower

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[26]The Dissent points out that when Ventura bought Saticoy in 1969, 60% of these new customers were residents; and, prior to the Saticoy acquisition, 1,000 of the service connections (i.e.older customers) were outside city limits. (Appendix 70-71.)

court decisions in the instant case also begs the intervention of this Court. The history of this 15 year old case demonstrates just how difficult it is to depend on the "last-ditch argument of equal protection" in attempting to remove the yoke of discriminatory rates. The attempt finally ends at this high Court. Appellants respectfully request that this Court reverse the California Supreme Court decision, and hold that the ordinances imposing the 70% surcharge on nonresident customers of the Ventura Water System deny them the equal protection of the laws and substantive due process.

July 2,1987

Respectfully submitted,
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